D.H. Howden & Co. Limited 1978 Annual Report

HOWDEN

Head Office
635 Southdale Road, London, Ontario

Auditors
TOUCHE ROSS & CO.

Listing of Common Stock
TORONTO STOCK EXCHANGE

General Counsel
HARRISON, ELWOOD, BARRISTERS AND SOLICITORS

Associated Company
COMPUTER HORIZONS (CANADA) LIMITED
President - S. R. Millar

Transfer Agents and Registrars
CANADA TRUSTCO
Toronto, Montreal, London, Winnipeg, Calgary, Vancouver

Annual Meeting
The Annual Meeting of the Shareholders of the Company will be held in the Carleton Room, Holiday Inn, 299 King Street, London, Ontario, on Thursday, the 24th day of May 1979 at the hour of 11:30 a.m.

Highlights

Highlights	1978	1977
Gross Sales - increase 11%	**75,011,367**	$67,873,794
Net income	**1,336,667**	1,205,827
Per Common Share	**2.40**	2.14
Inventories	**11,218,632**	8,326,397
Working Capital	**12,120,015**	9,979,676
Ratio of current assets to current liabilities	**2.18:1**	2.28:1
Shareholders' equity per Common share	**14.29**	12.27
Return on net worth	**18.51%**	19.02%

Directors

JOHN W. ADAMS, F.C.A.
President and Chief Executive Officer, Emco Limited
Director, Sifton Properties Limited

T. BRAYL COPP
President, Copp Builders' Supply Company Limited

JOHN B. CRONYN
Company Director, John Labatt Limited

JOHN D. HARRISON, M.B.E., Q.C.
Partner, Harrison, Elwood, Barristers and Solicitors

DONALD R. HUGHES
Retired; Formerly President, Spancan Inc.

NORMAN McBETH
Vice President-Finance, and Secretary Treasurer

DAVID H. M. STEWART
Chairman
President, Pro Hardware (Canada) Limited

MICHAEL C. TUCKER
Group Vice President, Merchandising and Distribution

JOSEPH H. UNGER
Retired; Formerly President, Metropolitan Stores of Canada Limited

Officers

D. H. M. STEWART
President and Chairman of the Board

N. McBETH
Vice President-Finance, and Secretary Treasurer

K. G. ALLASTER, C.A.
Vice President-Controller

W. J. TARVIT
Vice President of Marketing-Hardware Division

F. P. FORAN
Vice President of Marketing-Building Supply Division

C. W. K. LEROY
Vice President of Marketing-Electrical Supply Division

R. C. McKERLIE
Vice President-Merchandising

M. C. HUMPHREY
Vice President-Distribution

M. C. TUCKER
Group Vice President, Merchandising and Distribution

President's Report to Shareholders

The Company in 1978 again achieved record results and completed a profitable, progressive year, earning for our shareholders a return of 18.5% on their investment. We extend our thanks to our staff, suppliers, shareholders and particularly to our customers for making it all possible.

We report record sales and earnings for the year. Sales rose 11% to $75 million and resulted in net earnings of $1,336,667 an increase of 11% over 1977. Net profit return on shareholders' equity was 18.5% compared to 19.02% in 1977. Earnings per share were $2.40 compared to $2.14 in 1977.

During the year increased competition at retail levels precipitated pressure on corporate gross margins. Fortunately, through heightened productivity in the distribution centres, greater reliance on the computer, more efficient use of our trucking system, we have been able to handle higher sales volumes with but little addition to staff. Largely through productivity increases, we have been able to sustain net profit objectives while maintaining our competitive position.

All Marketing Divisions of the Company shared in corporate progress, and attained budgeted standards.

In transacting record sales of $75 million in 1978, it is of interest that taxes in the aggregate of $6.3 million were collected and paid to various levels of Government.

A particular highlight of the year was company expansion in Toronto through the acquisition of nine former Aikenhead Hardware stores. After purchasing these stores, the Company re-merchandised and modernized them to Pro standards and ultimately sold them to new franchised Pro Dealers. Efforts to upgrade our Pro Stores to quality shopping units continue and a number of new Company programs enhance this objective.

The Company's undertaking to become a truly National Distributor with sales base in all Provinces of Canada is meeting with success. During 1978 we added to our list of Western Canada customers the Chimo Group of Building Supply Stores, headquartered in Manitoba. Success in this National Development is dependent on our ability to meet customers' service requirements through weekly truck deliveries. In 1979 plans are underway for company truck delivery into all Western Provinces. Quebec has progressed well in this aspect along with the Maritimes, and particularly has enjoyed our increased bilingual capability both in the field and in London. We now offer customers the opportunity of doing business in the language of their choice.

During the year the Company enlarged its customer advertising programs, not only in support of Pro Stores, but also with a new program to meet the needs of building supply dealers. As product lines become more complex, the function of consumer advertising is not only to create a desire for the products advertised, but to explain their use to the consumer.

The Company is expanding its White Oaks (London) distribution facility by a further 96,000 sq. ft. The new building has a 42 foot ceiling and will have high bay storage

equipment. It will accommodate all dealer shipping, assembly, order sortation, and case goods inventory. The older Southdale Road building will be used for processing repack merchandise. Packed merchandise will be moved to White Oaks in cages to join case goods for shipment to the dealer. This major improvement to our production flow will create needed space for future sales expansion.

The White Oaks expansion includes additional land which will be needed in the future when long term leases expire at Southdale Road. Options are available which can extend our lease at Southdale to the year 2007 at decreasing costs after 1986. These options will be exercised providing the building does not become functionally obsolescent and too costly to operate on a competitive basis.

Computer Horizons (Canada) Limited, our joint venture with Management Horizons of Columbus, Ohio, enjoyed a successful year. In spite of adverse U.S. exchange rates which eroded profit, the Company was able to retire the balance of past losses and now has established a net worth.

In reporting the results of 1978 on behalf of the Board of Directors, I express thanks to our staff for their support in achieving these results. Because of their extra efforts, distribution to them under our Employee Profit Sharing Program increased to approximately $112,000.

I also express thanks to Mr. Joseph H. Unger who has served as a Director since 1971 and who chooses not to stand for a further term, in favour of residence in Florida. The Board thanks him for his very significant services to the Company and we wish him well.

Mr. Norman McBeth, after 40 years of outstanding service to D.H. Howden & Co. Limited has requested early retirement from the company, and has asked that he be relieved of his duties as Secretary Treasurer. Mr. McBeth has agreed to continue as Secretary until after the Annual Meeting. The Board accepted his decision with great regret.

Mr. Ross Millar will undertake the Corporate Secretarial duties.

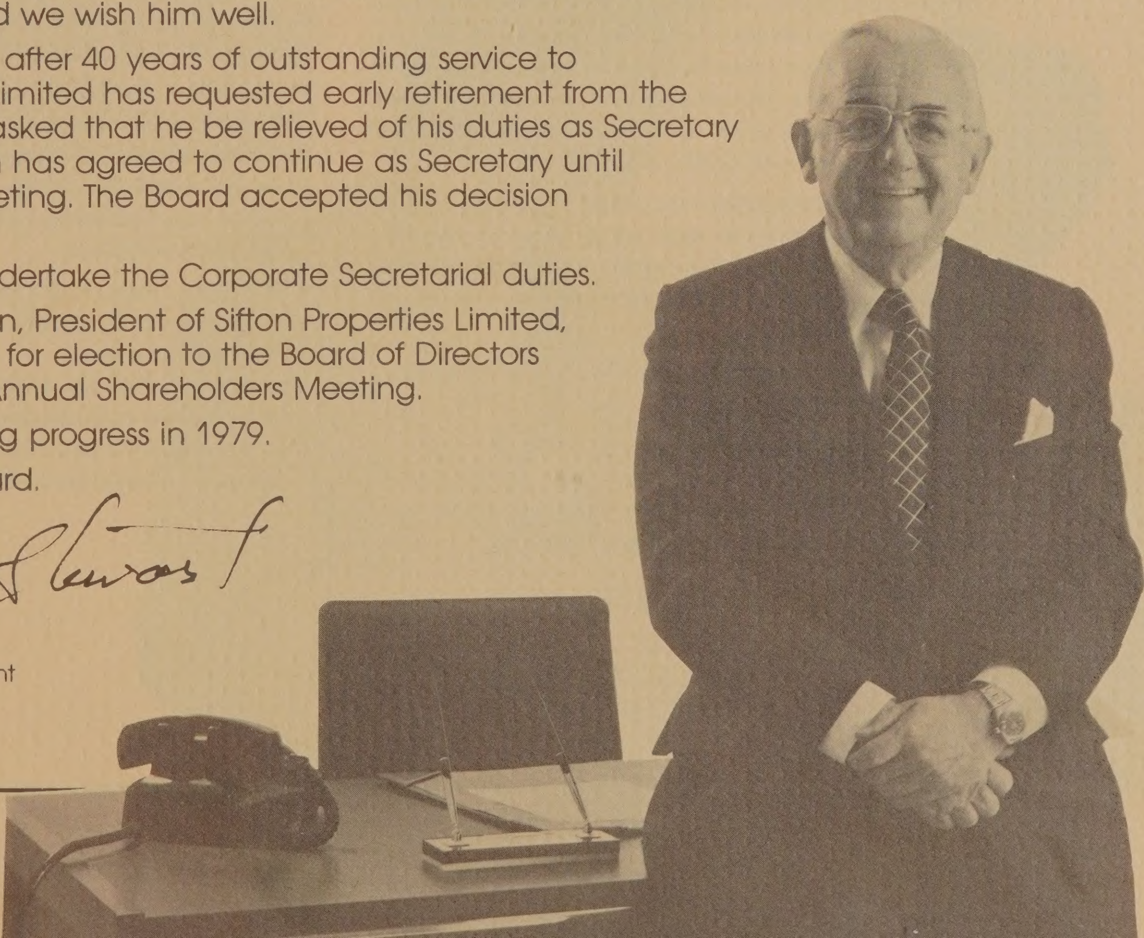
Mr. W. Mowbray Sifton, President of Sifton Properties Limited, has agreed to stand for election to the Board of Directors at our forthcoming Annual Shareholders Meeting.

We look to continuing progress in 1979.

On Behalf of the Board.

David H. Stewart

D.H.M. Stewart, President



The Marketing Organization

Howden regards itself as a forward looking and perceptive purchasing agent for the consumer making available best values in hardware, electrical supplies, sporting goods and products needed for the home. The consumer buys Howden services through franchised and selected dealers across Canada.

For success, both Howden and its retail affiliates must be so integrated that all unnecessary costs are eliminated from the distribution process and that a high turnover of assets is achieved. In this way Howden supplies merchandise to the consumer on a low cost competitive basis. Simultaneously, a satisfying return on investment to owners is assured. We call this process of integration of effort, Howden's Vertical Marketing System.

To keep pace with growth in consumer acceptance of our merchandising service, the White Oaks distribution centre in London, Ontario has been expanded by an additional 96,000 sq. ft. At this location new types of materials handling equipment will process orders on a lower cost basis. Total space for all hardware operational purposes now becomes 400,000 sq. ft.

Electrical construction materials are housed in and distributed from separate warehouses in London, Sarnia and Kitchener, supported to an increasing degree by centralized inventories at Southdale Road.

All processes are computerized at Head Office, Southdale Road.

The value of products moving through our distribution system to retailers has quadrupled since 1968. Four separate marketing divisions or channels of distribution are utilised.

The Hardware Dealer Division sponsors over 300 independently owned retail hardware stores, all identified under the Pro Hardware Franchise throughout Ontario and the Atlantic Provinces.

The Building Supply Division maintains supply contracts with 500 Home Improvement or Building Supply Dealers throughout the 10 Provinces of Canada.

The Sporting Goods Division supplies over 300 retail sporting goods dealers operative under Howden Marketing Agreements in Ontario.

The Electrical Supply Division services the needs of over 1000 contractors and users of electrical and lighting equipment through its distribution system in Western Ontario.

The Vertical Marketing System

Supporting these four channels of distribution is a Howden work force of over 395 people, all of whom with time have tended to become specialists and effective managers of their particular work area within the System.

In addition to meeting the hardware needs of the consumer, the goal of the Corporation is to make our customer more profitable. In doing so, Howden stresses within its Vertical Marketing System the following aims – all part of a growth oriented condition.

- to supply merchandise at a low cost basis;
- to supply to its retailers the proper assortment of merchandise;
- to communicate with consumers through informative advertising, and in store aids;
- to supply retailers needed financial and control systems to better manage their assets;

- to use electronic equipment to speed communications with dealers in different parts of Canada;
- to provide transportation in our own trucks and trailers to speed the flow of merchandise at low cost to dealers across Canada.

The Howden Merchandising Group researches continuously the hardware and home products need of the consumer. A model or basic stock is created which when inventoried by the retailer, meets 90% of his customer's hardware requirements. Needless duplications of items are eliminated. Choice is provided where necessary under the principle of 'good, better, best'. It makes shopping easier, it speeds up turnover of inventory, it reduces inventory loss through obsolescence.

Hardware dealers operate with 9,000 items of basic inventory, building supply dealers with 7,000. The latter do not carry houseware and gift items, but add more diversity in construction products. Changing inventory content reflects changes in consumer preferences, as well as manufacturers' efforts to meet new requirements. Naturally, Howden's computer plays a major role in adjusting model stocks to these conditions.

Howden supports the purchasing and merchandising programs of Pro Hardware (Canada) Limited for hardware and building supplies, Spancan Inc. for electrical materials, and Supreme Sports Limited for sporting goods. By combining with fellow members' contributions for volume, better purchasing cost so obtained permits further savings to reach the consumer.

Pro Hardware (Canada) Limited produces the advertising required by Pro stores as part of involving itself in the whole area of communicating with the consumer. On the other hand, Howden itself produces its own advertising programs required by customers of the Building Supply Division in furthering its expansion across Canada.

Major to the System is the Dealer Services Department. Its function is to design store layouts, to maintain staff who install the system in new stores, thus offering a "turn-key" operation to new dealers. This Department also communicates new product changes to the dealer and how they should be assimilated into the merchandising display.

The Dealer Financial Services Group has developed a range of computer services for dealer maintenance of accounts receivable, inventory control and financial statements. From raw data related to purchasing activity, and from electronic input from the store, Howden's computer produces finished statements which are sent to the store. A Financial Advisor is available as a consultant to arrange financing and to assist dealers in reaching their own performance targets.

Howden's stress on systems enables the retailer to concentrate his major efforts on servicing his customers. Whether it be merchandising, advertising campaigns, store engineering and layout, inventory control, reordering, financial planning or other day to day requirements of retail procedures, the task of the retailer is improved by Howden systems. Their goal is the improvement of productivity per person, per square foot of facility, and per dollar of investment.

Pro Retail Hardware Division

The family of Pro Retail Stores franchised by Howden covers Ontario and the Atlantic Provinces. Over 300 independent owners function as full line hardware stores or home centres.

The network grows annually. In 1978, 20 new high calibre franchised stores were added. The growth rate is expected to continue throughout 1979.

The steady sales expansion of recent years has been bolstered by internal store development as well as increased numbers. Today stores of 5,000 sq. ft. or more are in much demand. Product lines have broadened to include many more aspects of day to day living requirements. Quite apart from other ancillary lines, basic stock departments include:

- Hand and Power Tools
- Cabinet, Window, Door Hardware
- Construction Materials
- Plumbing, Heating, Electrical, Lighting Supplies
- Automotive Supplies
- Farm, Garden and Outdoor Living Supplies
- Cookware and Household Goods
- Electrical Housewares
- Winter and Summer Sports
- Firearms, Ammunition, Fishing Tackle

Two major developments commenced in 1978. Both are progressing well.

The Company's influence in the core of the heavily populated metropolitan Toronto area has never quite achieved its potential. During 1978, however, twelve new franchises were established in large and growing Toronto Mall locations. The stores are major in size with a broad inventory exposure. Typical of the shopping malls involved are Scarborough, Cedarbrae, Brampton, Northridge. The acquisition of nine well established Aikenhead outlets has acted as a springboard for other incursions into this heavily trafficked market segment.

In the smaller cities and towns, Pro Franchisees have from the beginning enjoyed a high level of market participation. But, as with urban shopping patterns, changes occur. In times past, the consumer was satisfied with traditional hardware requirements procurable

from his local store. For other needs of a home maintenance nature, he tended to patronize larger dealers in adjacent cities. This consumer now shows himself willing to purchase all his requirements from his local store, provided quality, variety and price meet his approval.

Many retailers welcome this opportunity for wider service and are finding ways to achieve it. One such method replaces the customary 2,000 - 4,000 sq. ft. downtown hardware location with a free-standing facility large enough – up to 10,000 sq. ft. – to accommodate and display a full line of all home requirements. The location naturally is of great strategic importance.

The home centre initiative is thus open to those who recognize markets which for generations have soundly supported hardware stores, but now reflect a need for broader satisfaction. In these endeavours Howden provides guidelines, building and engineering skills and financial counsel.

Prospects for continued real divisional growth in 1979 and 1980 bear largely on continued acquisitions to the Pro Franchise, and incremental growth from effectiveness of established stores. Both sources are valid potentials, backed by steadily evolving Howden merchandising systems.

Products

The consumer is showing strong demand for a growing list of new "do-it-yourself" products. Howden is in the forefront supporting this trend. Plumbing, electrical and decorative products are major examples.

A further new development is the "Leonardo Line" of high grade varnishes, polyurethanes and wood finishes.

To provide quality merchandise at lower cost, Howden imports directly from various parts of the world. Such imports include mechanic's tools – under the "Tul Shed" brand. Kitchen gadgets and other household products fall under "Kitchen Cupboard" brand. The trend is increasing.

In all, Howden inventories over 20,000 items of hardware and consumer products. Of this figure roughly 10,000 items are in high demand as basic stock merchandise, while the remaining 10,000 are carried to meet consumers' more special requirements.

Building Supply Division

Building Supply Dealers receive their hardware requirements from Howden and are serviced by Howden Building Products personnel.

In the late 1950's lumber yard dealers began to satisfy hardware requirements needed for home improvement activities. Since the bulk of such dealers' businesses was principally in building materials, many of them aligned themselves into building material buying groups to obtain better price.

Since 1958 Howden has become a contractual hardware supplier to a number of these groups and as a result has enhanced its sales expansion across Canada. These supply contracts stress store modernization, model stock, inventory control, computer ordering systems. More recently a greatly expanded consumer advertising program has been inaugurated which presents to the consumer do-it-yourself products and other building materials not necessarily sold by Howden.

All accounts are serviced from the London distribution centre. As with hardware dealers, orders are transmitted by telephone from the store into Howden computer using MSI transmitters. Over 35 tractor trailers transport orders to the stores and do so at lower freight cost. The trucks then pick up merchandise on their return trip to feed the order process in London.

Expansion occurring in this area of retailing prompts the Division to be very optimistic as to future growth, again backed by the Howden distribution system dedicated to the Dealer's total needs.

The Rise of the Home Centre

The home centre is an evolutionary outgrowth experienced by the building supply and hardware industries over the past ten years. It is a major Howden market.

Characterized by some as a major retailing phenomenon, it is the result of a variety of factors, such as:

- The rise in the cost of new residential housing.
- The rise in the cost of professional labour.
- A positive change in attitude towards social acceptability of performing do-it-yourself projects.
- The increase in the amount of leisure time.
- The awareness of manufacturers as evidenced by their changes in design and packaging of products.
- The flood of literature encouraging do-it-yourself assignments.

Data published by reliable U.S. sources, the inference of which applies equally to Canada, point out that the average sale price of new one family dwellings more than doubled in the twelve year period from 1965 to 1972. The average hourly rate for professional labour followed a similar pattern. The interaction between these two factors alone projected dynamic growth in building and home improvement products, the retailing of which almost trebled in the same period.

About 1960, traditional building material dealers adjusted to the wave of buying by opening cash and carry outlets. In mid 1960, fascination with the self-service sales approach took hold. In the later '60's the term "home centres" started to appear nationally. Charactistic of the new stores were such mass merchandising techniques as display and advertising, check out facilities and credit. Simultaneously personnel were developed to provide technical instruction in the use of products.

By 1972, the home centre concept had assumed a position of influence. New outlets were being established. Traditional sources such as building material dealers, hardware stores and department stores were undergoing transformation. Some of the recognizable characteristics are:

1. A sales potential which tends to exceed $500,000 annually.
2. A product mix which must include lumber, hardware, and interior wall panelling. But also there should be significant representation of at least half of the following product lines:
   - Hand and power tools
   - Windows and/or doors
   - Roofing products
   - Floor coverings and/or carpeting
   - Plumbing products
   - Electrical products
   - Paints and/or sundries
   - Wall coverings
   - Decorator products
   - Lawn and garden products
   - Kitchen cabinets
   - Ceiling products
   - Major appliances
   - Gifts
3. Sales floors large enough to properly display the products. In general terms, areas between 5,000 - 10,000 sq. ft. are practical. Some go as high at 50,000 sq. ft. Annual sales productivity per square foot is about $100.00 on the average.

While lumber and other wood products are the biggest single source of sales, products germane to hardware wholesalers are substantial. Decorator type items, fasteners, hand and power tools, cabinets, electric and plumbing supplies, paints and sundries, lawn and garden products, and housewares, generally account for 20-30% of total volume.

About 60% of customers are the do-it-yourself individual. The remainder is composed of builders and contractors, remodellers and other commercial and industrial accounts.

The profile of the do-it-yourselfer suggests an individual with a pleasant combination of positive attributes. He tends to be under fifty years of age, possibly affluent, reasonably well educated. He is usually a family man living in a household with one or more other people. Some surveys indicate that over half home centre customers have lived in their homes for 5 years or less, which suggests that owners who are new to their present home do make improvements and usually make them within 5 years of purchase.

Do-it-yourself home improvement thus becomes not only economically attractive, but fashionable as well. The householder, the young, the ambitious, the prosperous and near prosperous, the educated, and the homeowner, are all heavily involved in the movement.

Sporting Goods Division

About 300 retail sporting goods dealers are supplied by Howden under exclusive marketing agreements. These include specialists in guns and hunting supplies, all-inclusive sporting and team equipment dealers, selected mass merchandisers, and department stores.

Division sales increased satisfactorily during 1978 based primarily on lines related to hunting and fishing.

Recently Federally enacted Regulations impose restrictions on the sales, storage, display, recording, advertising and handling of firearms and ammunition. Retailers and wholesalers alike must maintain detailed sales and purchasing records, complete with product identification. Firearms are subject to locking devices of a sophisticated nature and must be stored under highly secured conditions. Advertising must also conform to certain subject matter restrictions.

The rigors of record keeping and product handling may tend to discourage other than well qualified retailers. The specialists who constitute much of the Howden clientele, therefore, should benefit.

The intent of the Regulations is to provide a measure of safety to the community at large. In so doing, it will add solidity to a substantial market and a popular pastime. All indications suggest that the industry is not only understanding of the new regulatory measures, but optimistic as to their outcome. Certainly such major manufacturers as Remington, Winchester, and others are looking for no diminution of the market.

Electrical Division

In spite of a troubled and uncertain construction market in Western Ontario, 1978 sales showed satisfactory increases. Most of these were recorded during the latter half of the year. With little encouragement from house building, the Division stepped up its approach to institutional construction and to industrial accounts. High rise apartment building in London and Sarnia was active. Expansion of manufacturing plants and equipment was similarly rewarding.

For the do-it-yourself customer, Howden's particular expertise is concentrated on lighting fixtures and related equipment. In catering to consumers' lighting needs, Howden has created a Retail Franchise Agreement under the name of "Lite Gallery". Sites are chosen in heavily trafficked retail areas. Model inventories are selected. Procedures for operations are designed. Preferences of the customer are continuously researched. Significant new business from this source is promising.

The Division is an active member of Spancan Inc. whose purchasing arm procures for its members advantages of group buying of all major product lines. Spancan provides numerous other services as well, related to national advertising, central warehousing, and freight programs.

Marketing Policy of the Division will be generally unchanged for 1979. Continued progress is anticipated.

Tomorrow's Market

Many of the characteristics of any consumer market are dictated by the life style of the dominant age group and by the demographics of the country. As change occurs within these elements, so too does marketing adjust and adapt.

Within Canada, the declining birth rate since 1960, and recessive immigration, cannot go unnoted. At present the dominant age group is from 20-24. By 1986, the 35 year old age group will have taken over.

Retailers therefore will be appealing to a young, but aging white collar oriented group; better educated with greater expectations; more conservative in outlook; and more ready to rely on plans for immediate financing. The consumer of the future while possessive of a higher average income, will be increasingly more value and quality oriented, and yet more open to reliance on credit.

For a variety of international as well as internal reasons arising particularly from inflation, the Canadian standard of living is eroding. While more dollars abound, many consumers expect their own standard of living will go down. There will therefore be a greater emphasis on "do-it-yourself" and "no-frills" merchandise, even for the affluent. Emphasis on quality and value will grow.

Retail dealers will therefore be required to have trained, knowledgeable sales staff to serve the consumer, and to carry quality and value merchandise to meet his requirements. Generic or non-service merchandise will be sold on a no-frills basis and at low margins.

Accompanying these retail buying trends, the better educated consumer will have a clearer understanding of the role of profit in society; and conversely, the disservice of a company which does not make a profit, is unable to generate tax revenues, to protect existing jobs, or to create new ones – all factors needed to maintain the standard of living we cherish.

D.H. Howden & Co. Limited is organized to meet these projected market changes.

Record sales of $75 million created net income of $1,336,667 or $2.40 per common share.

Working capital at year end was $12,120,015 an increase of $2,140,339 mainly attributable to increased term borrowing of $1 million and retention of earnings in a similar amount.

Dividends paid on common shares in 1978 were $206,250 which is an annual rate of 37.5 cents per common share compared to 32.5 cents per common share paid in 1977.

The rate of profit return on net worth is used by Howden Management when evaluating its effectiveness. It combines the three profit pathways: Management of Operations, Management of Assets, and Management of Funds. Our target is to deliver a 20% return on net worth.

Mgmt. of Operations		Mgmt. of Assets		Mgmt. of Funds		
$\frac{\text{Net Profit}}{\text{Sales}}$	×	$\frac{\text{Sales}}{\text{Assets}}$	×	$\frac{\text{Assets}}{\text{Net Worth}}$	=	$\frac{\text{Net Profit}}{\text{Net Worth}}$

Howden's performance over the past five years, based on quarterly averages is summarized as follows, using return on investment relationships.

	Net Profit to Sales		Sales Assets (Asset Turnover)		Assets - Net Worth (Financial Leverage)		Net Profit Net Worth
1974	1.97%	×	2.90	×	3.59	=	20.51%
1975	1.91%	×	2.93	×	3.40	=	19.07%
1976	1.59%	×	3.17	×	3.20	=	16.13%
1977	1.88%	×	3.10	×	3.27	=	19.02%
1978	1.88%	×	2.91	×	3.39	=	18.51%

The Return on Investment formula illustrates Howden's business strategy to be a low cost distributor that achieves a higher than normal turnover of assets and, at the same time making effective use of borrowed capital.

While 1978 net profit to sales remained similar to previous years, it did react to higher investment in inventory and receivables during the year. Financing the enlarged assets required increased borrowings which is reflected in the higher leverage factor of 3.39. Both changes resulted in higher borrowing cost.

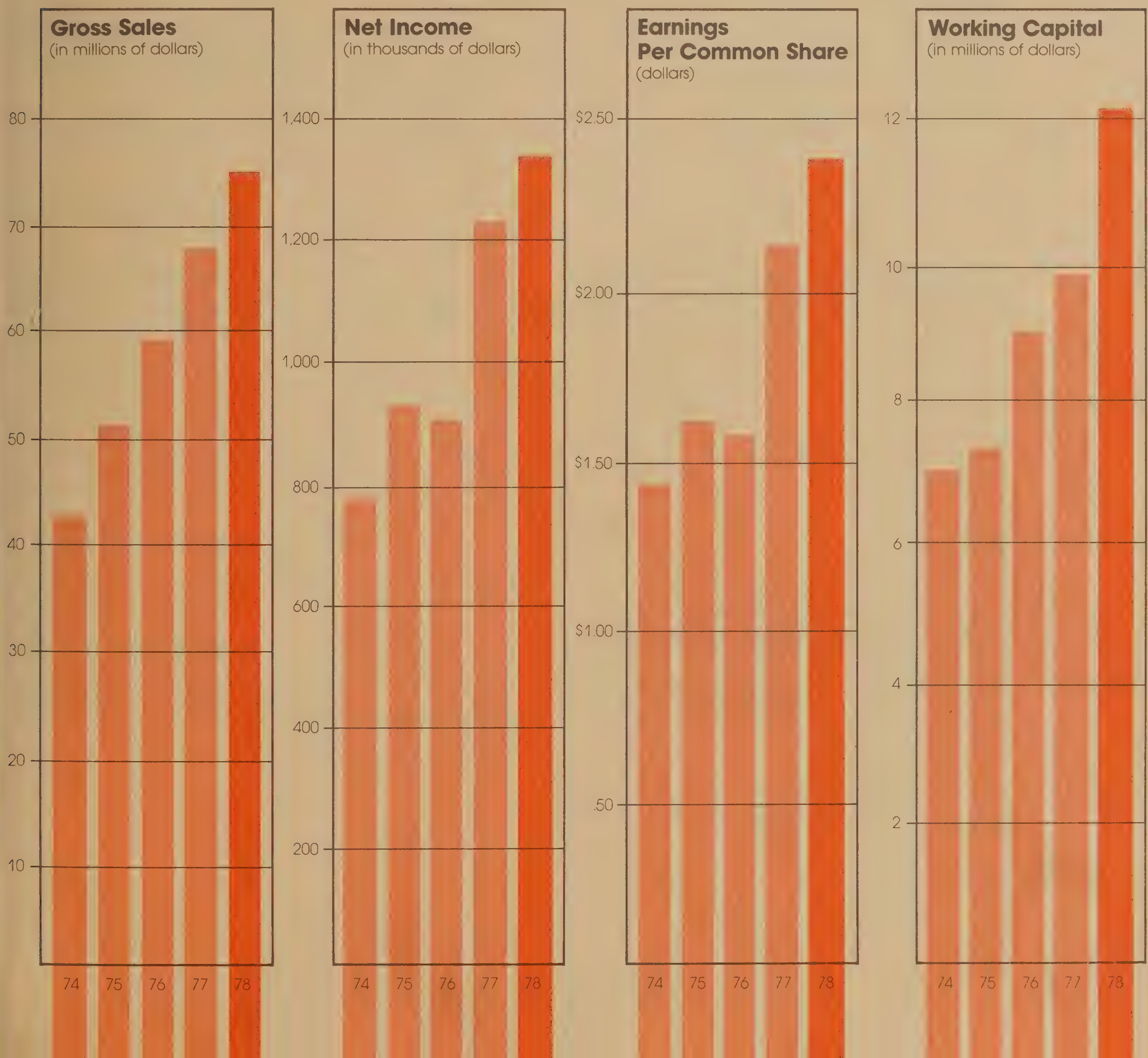
Net capital expenditure in 1978 was approximately $200,000. Purchase of warehouse and office equipment for normal updating and expansion purposes accounted for the bulk of these payments. The company's accounts during the year reflect the purchase of retail assets on specific sites in an approximate amount of $400,000 for subsequent resale to franchisees.

Of major importance was the company's decision to expand its White Oaks Sideroad distribution facilities. We expect volume to increase not only in Ontario but also to Eastern and Western Canada and that these markets can be best serviced from our London facilities. As a result of centralizing all distribution volume in London rather than developing multiple warehouses across Canada, cost can be reduced with all dealers enjoying lower priced merchandise as a result of the concentration.

Early in 1979, the Board of Directors decided to buy the White Oaks facilities and its additional land rather than to continue to lease the facilities as has been our policy to date. This will enable us to fix our costs and avoid possible future rent escalations resulting from continuing inflation. Should the future require further building additions, we would have the available land to meet such needs.

The purchase cost of White Oaks is $4,000,000 financed in total through long term borrowing.

Budgets for 1979 project profitable expansion by all Divisions.



D.H. Howden & Co. Limited and Subsidiary Companies (Incorporated under the Business Corporations Act - Ontario)

Consolidated Balance Sheet as at December 31

Assets	**1978**	1977
Current		
Cash	**$ 225,731**	$ 185,249
Accounts receivable	**10,822,768**	9,119,991
Inventories	**11,218,632**	8,326,397
Prepaid expense	**81,257**	141,560
	22,348,388	17,773,197
Equipment and leasehold improvements	**1,710,502**	1,455,759
Less accumulated depreciation and amortization	**837,262**	690,059
	873,240	765,700
Other		
Cash surrender value of life insurance	**23,492**	22,542
Equity in corporate joint ventures	**22,451**	138,071
Equity in unconsolidated subsidiaries	**5,730**	5,730
	51,673	166,343
	$23,273,301	$18,705,240

On behalf of the Board

Director D.H.M. STEWART

Director N. McBETH

Liabilities	1978	1977
Current		
Bank indebtedness (note 2)	**$ 2,909,000**	$ 1,100,000
Accounts payable	**5,797,712**	5,484,190
Accrued charges	**594,857**	492,126
Current portion of long-term debt (note 3)	**636,896**	676,134
Income taxes payable (note 4)	**289,908**	41,071
	10,228,373	7,793,521
Long-term debt (note 3)	**4,650,134**	3,691,547
Shareholders' Equity		
Capital stock (note 5)		
3% non-cumulative redeemable second preference shares		
of $1 par value each		
Authorized		
1978 - 1,188,500 shares; 1977 - 1,225,000 shares		
Issued		
1978 - 533,000 shares; 1977 - 473,000 shares	**533,000**	473,000
Common shares		
Authorized		
1,000,000 shares without par value		
Issued		
550,000 shares	**621,000**	621,000
Retained earnings	**7,240,794**	6,126,172
	8,394,794	7,220,172
	$23,273,301	$18,705,240

See accompanying Notes to Consolidated Financial Statements

D.H. Howden & Co. Limited and Subsidiary Companies

Consolidated Statement of Income

For The Year Ended December 31

	1978	1977
Gross sales	**$75,011,367**	$67,873,794
Less sales tax	**3,756,950**	3,585,943
	71,254,417	64,287,851
Cost of sales and operating expenses other than items noted below	**67,869,464**	61,496,099
Interest (note 6)	**898,867**	645,593
Depreciation and amortization	**132,713**	122,852
Operating profit	**2,353,373**	2,023,307
Share of net income of corporate joint ventures	**36,494**	33,520
Income before income taxes	**2,389,867**	2,056,827
Income taxes (note 4)	**1,053,200**	851,000
Net income for the year	**$ 1,336,667**	$ 1,205,827
Earnings per common share	**$2.40**	$2.14

D.H. Howden & Co. Limited and Subsidiary Companies

Consolidated Statement of Retained Earnings

For The Year Ended December 31

	1978	1977
Retained earnings, beginning of year	**$ 6,126,172**	$ 5,125,735
Net income for the year	**1,336,667**	1,205,827
	7,462,839	6,331,562
Dividends		
First preference shares	—	13,875
Second preference shares	**15,795**	12,765
Common shares	**206,250**	178,750
	222,045	205,390
Retained earnings, end of year	**$ 7,240,794**	$ 6,126,172

See accompanying Notes to Consolidated Financial Statements

D.H. Howden & Co. Limited and Subsidiary Companies

Consolidated Statement of Changes in Financial Position

For The Year Ended December 31

Source of working capital	**1978**	1977
Funds provided from operations		
Net income for the year	**$ 1,336,667**	$ 1,205,827
Non-fund items		
Depreciation and amortization	**132,713**	122,852
Profit on disposal of equipment and leasehold improvements	**(32,469)**	—
Share of net income of corporate joint ventures	**(36,494)**	(33,520)
	1,400,417	1,295,159
Disposal of equipment and leasehold improvements	**423,740**	900
Reduction of investment in corporate joint ventures	**152,114**	43,653
Long-term debt	**1,571,428**	800,000
Second preference shares issued	**96,500**	63,000
	3,644,199	2,202,712

Application of working capital		
Equipment and leasehold improvements	**631,524**	275,576
Cash surrender value of insurance	**950**	1,009
Long-term debt	**612,841**	515,550
Redemption of first preference shares	—	146,050
Purchase of second preference shares	**36,500**	36,000
Dividends	**222,045**	205,390
	1,503,860	1,179,575
Increase in working capital	**$ 2,140,339**	$ 1,023,137

See accompanying Notes to Consolidated Financial Statements

Notes to Consolidated Financial Statements

December 31, 1978

1. Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the company and its wholly-owned subsidiaries, D.H. Howden Stores (Central) Limited, Cowan Hardware (1968) Limited and Howden-Howland Limited.

The equity of D.H. Howden & Co. Limited in unconsolidated subsidiaries consists of the company's investment in Pro Hardware (Canada) Limited and in Spancan Inc. Although these two companies are technically subsidiaries of D.H. Howden & Co. Limited through ownership of voting control, in substance they represent corporate joint ventures on the part of a number of non-competing wholesalers who participate in an integrated merchandising programme and volume purchasing. It was considered inappropriate to consolidate the assets and liabilities of these companies since they consist primarily of amounts due from unrelated companies of these subsidiaries on their behalf. All the expenses of these companies and volume discounts derived from their operations are apportioned to participating member companies. The share of D.H. Howden & Co. Limited in these expenses and volume discounts is reflected in the accompanying financial statements.

Investments in corporate joint ventures, Computer Horizons (Canada) Limited and Supreme Sports Limited, are carried at Howden's share of equity therein and advances to such corporations. The company's share of their earnings is included in consolidated net income.

Inventories

Inventories consist of finished goods and are valued at the lower of cost on a first-in, first-out basis and net realizable value.

Equipment and leasehold improvements

Equipment and leasehold improvements are recorded at cost and depreciated or amortized over their estimated useful lives. Equipment is depreciated using the declining balance method at rates of 20% and 30% and leasehold improvements are amortized using the straight-line method over the term of the relevant lease.

2. Bank Indebtedness

Bank indebtedness is secured by an assignment of accounts receivable.

3. Long-term Debt

	1978	1977
Fixed and floating charge bank debenture payable $257,142 semi-annually with a final payment of $1,400,000 maturing May 5, 1985, with interest varying from time to time related to the lender's cost of borrowing. The rate at December 31, 1978 was 11.05%	**$4,742,858**	$3,714,286
8% mortgage, payable $290 monthly with interest and maturing September 30, 1990	**26,612**	32,695
6% secured sinking fund debentures maturing May 1, 1989	**517,560**	620,700
	5,287,030	4,367,681
Less portion due within one year	**636,896**	676,134
	$4,650,134	$3,691,547

The security provided for the 6% sinking fund debentures is a floating charge on all company assets but such security is subordinate to that provided for the bank debenture.

The annual sinking fund provision is comprised of 10% of the company's unconsolidated net income exclusive of extraordinary items. The provision for 1979 is $124,825 (1978 - $103,134).

4. Income Taxes

The income tax provision for 1978 has been reduced by $122,000 to reflect the 3% inventory tax allowance.

5. Capital Stock

Second preference shares

During 1978 96,500 second preference shares were issued for cash and 36,500 shares were acquired at par value.

6. Interest on Long-term Debt

Interest on long-term debt amounted to $478,790 in 1978 (1977 - $376,566).

7. Lease Commitments

The company has entered into lease agreements with varying expiry dates to November 30, 2000 for certain buildings and equipment. The annual lease payments required for the next five years are as follows:

	Property	Equipment
Year ending		
December 31, 1979	$ 425,000	$ 161,000
1980	414,000	114,000
1981	367,000	96,000
1982	362,000	69,000
1983	356,000	50,000
	$1,924,000	$ 490,000

8. Remuneration of Directors and Senior Officers

The aggregate direct remuneration for 1978 of the directors and senior officers amounted to $372,600 of which $338,700 was paid by the company and its consolidated subsidiaries and $33,900 was paid by unconsolidated subsidiaries.

9. Contingent Liabilities

The company was contingently liable at December 31, 1978 as follows:

Guarantee of franchise store leases	$1,731,000
Guarantee of trade paper	1,127,000
Guarantee of corporate joint venture bank indebtedness	190,000
	$3,048,000

10. Subsequent Event

In 1979 the company is negotiating for the purchase of land and buildings at an approximate price of $4,000,000 to be financed substantially through conventional mortgages.

Auditors' Report

The Shareholders,
D.H. Howden & Co. Limited.

We have examined the consolidated balance sheet of D.H. Howden & Co. Limited at December 31, 1978 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

London, Ontario
February 16, 1979

TOUCHE ROSS & CO.
Chartered Accountants.

10 Year Highlights

	1978	1977	1976 (Restated)	1975
Operating Results				
Gross sales	**$75,011,367**	$67,873,794	$59,806,176	$51,028,667
Income before income taxes and extraordinary items	**2,389,867**	2,056,827	1,582,782	1,743,458
Income taxes	**1,053,200**	851,000	680,000	824,500
Income before extraordinary item	**1,336,667**	1,205,827	902,782	918,958
Extraordinary item	—	—	—	—
Net income	**1,336,667**	1,205,827	902,782	918,958
Retained earnings	**7,240,794**	6,126,172	5,125,735	4,415,839
Financial Position				
Accounts receivable	**10,822,768**	9,119,991	7,241,987	7,789,567
Inventories	**11,218,632**	8,326,397	7,919,376	6,164,665
Total current liabilities	**10,228,373**	7,793,521	6,582,794	6,876,039
Working capital	**12,120,015**	9,979,676	8,956,539	7,378,251
Long-term debt	**4,650,134**	3,691,547	3,407,097	2,492,536
Shareholders' equity	**8,394,794**	7,220,172	6,338,785	5,582,139
Return on net worth (January 1)	**18.51%**	19.02%	16.13%	19.07%
Per Common Share				
Earnings before extraordinary item	**2.40**	2.14	1.59	1.62
Net earnings	**2.40**	2.14	1.59	1.62
Shareholders' equity	**14.29**	12.27	10.45	9.16

1974	1973	1972	1971 (Restated)	1970 (Restated)	1969
$42,766,017	$32,476,731	$27,794,722	$22,045,644	$20,118,085	$21,796,287
1,644,495	1,296,869	875,375	399,964	182,518	366,606
862,500	670,000	444,000	258,800	115,600	182,695
781,995	626,869	431,375	141,164	66,918	183,911
—	10,000	134,824	—	—	181,990
781,995	636,869	566,199	141,164	66,918	365,901
3,662,412	3,013,910	2,397,394	1,852,261	1,732,001	1,686,576
6,290,762	5,182,223	4,940,433	3,695,805	3,089,443	3,092,691
5,949,297	3,780,499	3,331,779	2,651,372	2,592,864	2,803,080
5,520,091	4,995,634	4,662,107	3,277,627	2,906,757	3,156,881
6,959,009	4,142,126	3,737,735	3,241,458	3,081,534	3,075,046
2,785,200	875,348	991,109	1,072,856	1,093,241	1,123,664
4,819,162	3,812,560	3,204,894	2,655,811	2,535,551	2,498,876
20.51%	19.89%	16.22%	5.57%	2.68%	8.46%
1.44	1.21	.82	.24	.09	.32
1.44	1.23	1.09	.24	.09	.68
7.79	6.61	5.38	4.29	4.05	3.95